No. 18-457

IN THE

Supreme Court of the United States

NORTH CAROLINA DEPARTMENT OF REVENUE,

Petitioner,

v.

THE KIMBERLEY RICE KAESTNER 1992 FAMILY TRUST,

Respondent.

On Writ of Certiorari to the Supreme Court of North Carolina

BRIEF OF AMERICAN COLLEGE OF TAX COUNSEL AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

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BRIEF OF AMERICAN COLLEGE OF TAX COUNSEL AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

The American College of Tax Counsel (the "College") respectfully submits this brief as *amicus curiae* in support of Respondent.[1]

STATEMENT OF INTEREST

The College is a nonprofit professional association of tax lawyers in private practice, in law school teaching positions, and in government, who are recognized for their excellence in tax practice and for their substantial contributions and commitment to the profession.[2]

The College is composed of approximately 700 Fellows recognized for their outstanding reputations and contributions to the field of tax law and is governed by a Board of Regents consisting of one Regent from each federal judicial circuit, two Regents at large, the Officers of the College, and the last retiring President of the College. As part of its mission to improve the tax

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[1] Pursuant to Supreme Court Rule 37.6, counsel for *amicus curiae* states that no counsel for a party authored this brief in whole or in part, and no party or counsel for a party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than *amicus curiae*, its members, or its counsel made a monetary contribution to its preparation or submission. All parties have consented to the filing of this brief.

[2] The purposes of the College are to foster and recognize the excellence of its members and to elevate standards in the practice of the profession of tax law; to stimulate development of skills and knowledge through participation in continuing legal education programs and seminars; to provide additional mechanisms for input by tax professionals in development of tax laws and policy; and to facilitate scholarly discussion and examination of tax policy issues.

system, the College provides recommendations to Congress and the Internal Revenue Service for improving the nation's tax laws and the way that they are interpreted and administered, and it provides input to the Court by filing *amicus* briefs in selected tax cases.[3]

It is the view of the Board of Regents of the College that trustees, settlors, and trust beneficiaries are each distinct entities, while trusts are treated as separate taxable entities for federal and state tax purposes. Exercise of State power over a trust and its trustee based solely on the in-state presence of a contingent trust beneficiary could meet due process requirements only if those important distinctions were disregarded. Such disregard would be contrary to decades of modern jurisdictional precedent. The College submits this *amicus* brief because it is concerned that the position espoused by Petitioner would create tax jurisdiction chaos between states and non-resident sources of potential tax revenue and would have far-reaching and unpredictable consequences for trust administration and advice provided by tax practitioners, including Fellows of the College.

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[3] This *amicus* brief is submitted by the College's Board of Regents and does not necessarily reflect the views of all members of the College, including those who are government employees, academics, and law school professors, some of whom have appeared separately before the Court as *amicus curiae* in this case.

SUMMARY OF ARGUMENT

Both this Court's jurisprudence and North Carolina law recognize that Due Process Clause personal jurisdiction over nonresident trustees and the assets they manage should be exercised by the State in which the trust is managed and administered, not the States in which beneficiaries may reside. The relationship between trustee and beneficiary, standing alone, does not permit exercise of jurisdiction over the nonresident trustee by the State of domicile of a trust beneficiary.

Nothing in *South Dakota v. Wayfair*, 138 S. Ct. 2080 (2018), changed this fundamental Due Process principle. *Wayfair* brought the application of the Commerce Clause for sales taxes in line with other forms of State taxation by recognizing that there was no longer any basis for a physical-presence nexus requirement exclusive to sales tax. The essential Due Process mandate set forth in *Quill Corp. v. N.D.*, 504 U.S. 298 (1992), growing from *Int'l Shoe Co. v. Wash.*, 326 U.S. 310 (1945), that the "person, property, or transaction" sought to be taxed must have "purposefully availed" itself of the forum State, stands unchanged by *Wayfair*. The lower court's decision properly applied that long-standing Due Process requirement to determine that the nonresident trustee lacked a definite connection to North Carolina. Rather than "modernizing" trust taxation, Petitioner's position invents a new nexus rule specific to trusts that exists nowhere else in the Court's tax nexus jurisprudence. Such a rule would invite analogous tax treatment of nonresident corporations and other entities solely based on their relationships with in-state shareholders or interest owners, a result that this Court has never reached.

Multiple precedents of this Court would need to be re-evaluated, and likely overruled, in order to reach

the result sought by Petitioner, including the seminal decision of *Hanson v. Denckla*, 357 U.S. 235 (1958). Since this Court's jurisdiction-to-tax case law grows from the same roots that form the *in personam* and *in rem* jurisdictional framework described in *Hanson*, it would be unwise to create a variant jurisdictional test allowing North Carolina to exercise tax jurisdiction over a nonresident trustee over whom it does not have adjudicative jurisdiction.

Moreover, fracturing this Court's jurisprudence on minimum contacts to draw a distinction between adjudicative jurisdiction and prescriptive or tax jurisdiction, solely to permit the State to reach income earned out of state which was never distributed to any in-state beneficiary, is an unnecessary and ill-advised expansion of the Due Process Clause's jurisdictional limits. Examination of the North Carolina trust tax law and of the trust instrument in this case further illuminates why the income of the trust must be attributed to the trustee, not to a contingent beneficiary, and be subject to tax only by the State in which the trustee resided and purposefully availed himself.

Finally, the state-tax revenue loss assertion by Petitioner is a misnomer. State tax revenue is an expected consequence of choices made by each State regarding the structure of its tax system, and the responses of each citizen to the incentives created through those tax systems. Connecticut's choice to limit the scope of its taxation of resident trusts does not empower North Carolina to exercise State tax authority beyond its borders.

ARGUMENT

I. PERSONAL JURISDICTION OVER NON-RESIDENT TRUSTEES, AND THE TRUST ASSETS THEY OWN, IS EXERCISED BY THE STATE IN WHICH THE TRUST IS MANAGED AND ADMINISTERED, NOT THE STATES IN WHICH BENEFICIARIES RESIDE.

"A trust is a fiduciary relationship with respect to property, arising from a manifestation of intention to create that relationship and subjecting the person who holds title to the property to duties to deal with it for the benefit of charity or for one or more persons, at least one of whom is not the sole trustee." Restatement (Third) of Trusts, § 2 (2003). At least 31 states and the District of Columbia have adopted the Uniform Trust Code ("UTC"), promulgated by the National Conference of Commissioners on Uniform State Laws.[4] Many of the states that have not adopted the UTC have already in place comprehensive State codes regulating trusts and trustees. *Id.*

Under the UTC, the key figure for assessing personal jurisdiction over a trust is the trustee. A trustee submits personally to the jurisdiction of a State court regarding any matter involving the trust if the trust's

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[4] The adopting states are Alabama, Arizona, Arkansas, Florida, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Mississippi, Missouri, Minnesota, Montana, Nebraska, New Hampshire, New Jersey, New Mexico, North Carolina, North Dakota, Ohio, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, Utah, Vermont, Virginia, West Virginia, and Wyoming. *See* GEORGE C. BOGERT ET AL., THE LAW OF TRUSTS AND TRUSTEES: A TREATISE COVERING THE LAW RELATING TO TRUSTS AND ALLIED SUBJECTS AFFECTING TRUST CREATION AND ADMINISTRATION, WITH FORMS, § 7 (3rd ed. 2001, July 2018 update).

principal place of administration is in the forum State. U.T.C. § 202 (2010), (*codified in North Carolina at* N.C. Gen. Stat. § 36C-2-202(a) (2005)). Beneficiaries of a trust with its principal place of administration in a State are subject to the jurisdiction of that State for any matters involving the trust. *Id.* While this provision of the North Carolina trust statute purports to subject the beneficiary to the jurisdiction of the State where the administration of the trust occurs, no provision of the North Carolina statute or the UTC would purport to subject a trustee (or a trust) to the jurisdiction of the State where the beneficiary resides, unless some other basis for jurisdiction existed.[5]

Had a dispute arisen between Ms. Kaestner and the trustee, Ms. Kaestner's claim would have been properly brought in the state or federal courts of the State of administration of the trust, not in North Carolina's courts. North Carolina's codification of the UTC would not permit a North Carolina court to exercise personal jurisdiction over a trustee administering the Kaestner Trust in New York so long as no other basis for personal jurisdiction existed.

This statutory scheme is not merely a result of legislative policy, but also a recognition of the Due Process Clause limits on the exercise of state power over nonresident trusts and their trustees – a principle well-recognized by North Carolina's courts. In *Skinner v. Preferred Credit*, 638 S.E.2d 203 (N.C. 2006), the Supreme Court of North Carolina considered whether the State had specific jurisdiction over a nonresident mortgage loan trust defendant when (1) the trust held

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[5] The UTC "does not preclude other methods of obtaining jurisdiction over a trustee, beneficiary, or other person receiving property from the trust." N.C. Gen. Stat. § 36C-2-202(c) (2005).

a loan originated in North Carolina; (2) the trust owned a deed of trust on North Carolina property; and (3) loan payments from North Carolina were deposited into the trust on a systematic basis. Even with these contacts between in-state residents and a nonresident mortgage loan trust, the North Carolina Supreme Court held that there were insufficient contacts under the Due Process Clause to allow exercise of jurisdiction over the nonresident trust. *Id.* at 213, applying *Int'l. Shoe Co. v. Wash.*, 326 U.S. 310 (1945).

The evidence presented in *Skinner* failed to establish minimum contacts because (1) the Trust was created outside the State, had its day-to-day operations in New York, and only 3% of its loan assets had ties to North Carolina; (2) the North Carolina interest held by the Trust was "simply a beneficial interest" in North Carolina property – the trust did not hold title to any North Carolina property; and (3) the trust served as a depository for income received by the loan servicer from North Carolina, among other states. The court explained that its cases analyzing minimum contacts "rarely have dealt with so 'passive' a defendant." *Id.* at 211. It compared the nonresident mortgage trust's contacts to those in a case concerning a nonresident person who signed a conditional promissory note guaranteeing a debt to a North Carolina company, but who had no other contacts with the State. The court held such contacts were also insufficient for the nonresident guarantor on the note to be made a defendant in a North Carolina action. Even though "the defendant signed a note that created a relationship with North Carolina residents, [the court] could not automatically exercise personal jurisdiction." *Id.*, citing *United Buying Group, Inc. v. Coleman*, 251 S.E.2d 610 (1979). The trustee's "relationship" with Ms. Kaestner

is similarly insufficient for North Carolina to exercise personal jurisdiction over the trust.

The goals of "minimum contacts" jurisprudence are to "safeguard[] the defendant from being required to defend an action in a distant or inconvenient forum" and to "prevent[] a state from escaping the restraints imposed upon it by its status as a coequal sovereign in a federal system." *Skinner,* 638 S.E.2d at 210 (citing *Miller v. Kite*, 329 S.E.2d 663, 665 (N.C. 1985) (citing *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286 (1980).)) Part and parcel of the minimum contacts principle is that the contacts at issue must be those of the "person, property or transaction," *Quill*, 504 U.S. at 306, being subjected to the tax. The contacts of related entities are not attributed to the party over whom the State seeks to exert its power. *Brooke v. City of Norfolk*, 277 U.S. 27 (1928) (residency of a trust beneficiary was not attributed to the nonresident trustee).

In the context of a nongrantor discretionary trust with contingent[6] beneficiaries, it is particularly inappropriate to attribute the contacts of the beneficiary to the trust or the trustee. The beneficiary has no authority to direct the actions of the trustee. Absent an abuse of *discretion* on the part of the trustee, Ms. Kaestner possessed no legally enforceable right of any kind over

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[6] Because Ms. Kaestner did not have a right under the Trust to receive all or a portion of the income generated by the Trust assets in a particular year or on demand, her interest was contingent in nature until the conditions precedent to receipt of income were satisfied – in this case, the exercise of the absolute discretion of the trustee. *See* Trust Agmt. §1.2(a), JA at 47, further discussed at Section II.D., *infra* and Amicus Brief of American College of Trust and Estate Counsel ("ACTEC") at 8.

the actions of the trustee or the control, disposition, or deployment of the Family Trust assets.[7]

Receiving a distribution is certainly a taxable event in the State in which the recipient beneficiary resides. For example, the power of Virginia to tax a trust *distribution* received by a Virginia resident from a New York trust, after the trust's income had already been taxed by New York, was recognized in *Guaranty Trust Co. of N.Y. v. Va.*, 305 U.S. 19 (1938), and was based on Virginia's power under the Due Process Clause "to tax something done within her borders." *Id.* at 23. ("[T]he taxing power of a state is restricted to her confines and may not be exercised in respect of subjects beyond them. Here, the thing taxed was receipt of [nonresident trust] income within Virginia by a citizen residing there.") Of course, unlike the beneficiary in *Guaranty Trust*, Ms. Kaestner received no distributions during the tax years at issue.

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[7] Attributional nexus cases, such as *Tyler Pipe Ind., Inc. v. Wash. State Dept. of Revenue*, 483 U.S. 232 (1987) and *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960), rely on in-state activities by employees or agents of companies to create nexus to an otherwise out-of-state company. Since Ms. Kaestner took no actions in North Carolina that could be attributed to the Trust or trustee, the State cannot rely on attributional nexus.

II. STATES MAY ONLY EXERCISE TAXING POWER OVER NONRESIDENT ENTITIES WHO HAVE A DEFINITE LINK OR MINIMUM CONNECTION TO THE TAXING STATE.

A. *South Dakota v. Wayfair* Underscores the Due Process Clause's Requirement that a Taxed Entity Must Have "Purposefully Availed" Itself of the Taxing State.

South Dakota v. Wayfair, 138 S. Ct. 2080 (2018), harmonized the Court's Commerce Clause jurisprudence as applied to so-called "remote seller" sales tax cases by holding that in-state physical presence was no longer a mandatory prerequisite to the exercise of State sales taxing power under the Commerce Clause. In so holding, however, *Wayfair* made no change to the Court's long-standing views on Due Process Clause nexus for the exercise of State taxing power.[8]

In *Quill*, the Court explained that the Due Process Clause requires "some definite link, some minimum connection, between a state and the person, property, or transaction it seeks to tax," *Quill*, 504 U.S. at 306 (citing *Miller Brothers Co. v. M.S.*, 347 U.S. 340, 344-345 (1954)), "and that the income attributed to the State for tax purposes must be rationally related to 'values connected with the taxing State.'" *Quill*, 504 U.S. at 307 (emphasis added) (citing *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273 (1978)).[9]

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[8] *Quill* recognized that States had Due Process nexus to impose a sales tax on out-of-state vendors for sales purposely directed to that State's residents.

[9] Petitioner's Brief at 15 inaccurately states the test established in *Quill*, claiming that the Trust must show that both

The first of these two tests was analyzed by a flexible inquiry directed at whether the contacts between the entity and the forum State made it reasonable to require the entity to defend itself in that State. *Quill*, 504 U.S. at 307 (applying *Int'l Shoe*, 326 U.S. 310). This test applies for both *in personam* and *in rem* jurisdiction after *Shaffer v. Heitner*, 433 U.S. 186 (1977).

Applying this test in the tax context, *Quill* explained that a foreign corporation that "purposefully avails" itself of the forum State would subject itself to *in personam* jurisdiction under the Due Process Clause even if it has no physical contact with the State. *Quill*, 504 U.S. at 307-308 (citing *Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985)). A "mail-order house that is engaged in continuous and widespread solicitation of business within a State" meets the purposeful availment test, giving the State authority under the Due Process Clause to exercise its taxing power over that corporation. *Quill*, 504 U.S. at 308.

Essential to this analysis is a critical focus on who is "the person, property, or transaction [North Carolina] seeks to tax." *Quill*, 504 U.S. at 306. Petitioner undertakes a substantial effort to make it appear as if it is taxing the beneficiary, focusing substantially on the beneficiary's presence in the State and arguing that the incidence of the tax falls upon the beneficiary. But

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prongs of the Due Process Clause test in *Quill* are not met. Instead, the College submits that it is the burden of the party exerting jurisdiction to prove that its claimed authority meets both prongs: "some definite link, some minimum connection" with "the person, property, or transaction it seeks to tax" and that the "income [is] rationally related to values of the taxing state." If either of these prongs of the test is not met, the taxing authority has exceeded the jurisdictional limits set by the Due Process Clause. *Quill*, 504 U.S. at 306.

the *thing* being taxed here is not the beneficiary and is not the income of the beneficiary; rather, it is the income of the trust in the legal possession of the trustee.

N.C. Gen. Stat. § 105-160.2 levies income tax on "the taxable income of estates and trusts." Income is defined by cross-reference to the Internal Revenue Code (subject to certain state-specific adjustments). The North Carolina statute provides that

> [t]he tax is computed on the amount of the taxable income of the estate or trust *that is for the benefit of a resident of this State*, or for the benefit of a nonresident to the extent that the income (i) is derived from North Carolina sources and is attributable to the ownership of any interest in real or tangible personal property in this State or (ii) is derived from a business, trade, profession, or occupation carried on in this State. . . . The fiduciary responsible for administering the estate or trust shall pay the tax computed under the provisions of this Part.

N.C. Gen. Stat. 105-160.2 (2017) (*emphasis added*).

The North Carolina statute further requires that the trust's fiduciary – not the beneficiary – pay the tax and that the trust's fiduciary file the return, including for trusts "which the Secretary believes to be liable for a tax under this Part, when so notified by the Secretary and requested to file a return."[10]

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[10] A nonresident trustee lacking minimum contacts who does not file a trust tax return upon notice of the Secretary would not be subject to the personal jurisdiction of the North Carolina courts to enforce such a requirement. *Hanson*, 357 U.S.at 235. If the State has no adjudicative jurisdiction over the trustee, there

There is no Due Process minimum connection where a trust has engaged in no business in North Carolina, has held no assets in North Carolina, has no trustee or trust office in North Carolina, and otherwise has no connection to North Carolina. Presence of a contingent beneficiary in the State does not cause the trust to have minimum contacts with North Carolina, just the same as the presence of a shareholder in a State does not cause a corporation to have minimum contacts in a forum State.

B. A Nonresident Trustee Does Not "Purposefully Avail" Himself, or the Trust He Manages, of the Jurisdiction of a Foreign State Simply Due to the Presence of an In-State Beneficiary.

Applying the legal framework established in *Quill*, it is evident that nonresident trustees do not "purposefully avail" themselves to the jurisdiction of a foreign state merely due to the presence of an in-state beneficiary.

A trust, through its trustee, will be expected to engage in acts designed to fulfill the purposes of the trust instrument in compliance with the fiduciary duties imposed upon the trustee and the legal obligations of the trust's governing law. The trustee engages in financial and business transactions on behalf of the trust as appropriate to the goals of the trust. In so doing, the trustee makes decisions about where to conduct the trust's business, how to generate income for the trust, in which investments or other financial transactions to engage, and where and how to acquire,

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is no enforcement mechanism for the asserted tax. *See* Section IV, *infra*.

hold, or divest trust property. Each of those decisions may cause the trust assets or the trustee to become involved in business activities in one or more states.

Similarly, a corporation's directors and officers operate under fiduciary obligations to the corporation's shareholders.[11] They engage in business and financial transactions to conduct business for the purpose of maximizing shareholder value. The corporation's business activities cause the corporation to generate income, which may be retained and re-invested in the corporation's business activities or may be distributed to shareholders.

The essential requirement that a corporation must have shareholders, just as a trust must have beneficiaries, has never led the Court to conclude that a corporation has minimum contacts with a State solely based on the residence of a corporate shareholder. Rather, the Court's due process holdings establish that a shareholder's State of residency is not imputed to the corporation for purposes of that corporation's minimum contacts. *Shaffer*, 433 U.S. at 213 (determining that stock holdings in a corporation, which are not the subject matter of the litigation and are unrelated to the underlying cause of action, do not provide contacts sufficient to support personal jurisdiction). A corporation having no contacts with the State of North Carolina other than the in-state residence of a shareholder could not, under the Due Process Clause, be subject to corporate income tax in North Carolina.

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[11] The Official Comment to Section 8.30 (Standards of Conduct for Directors) of the Model Business Corporation Act of 2016 states that "[t]he standards of conduct for directors established by section 8.30 are analogous to those generally articulated by courts in evaluating director conduct, often referred to as the duties of care and loyalty." MODEL BUS. CORP. ACT § 8.30 (2016).

Just as "it strains reason . . . to suggest that anyone buying securities in a corporation formed in [a State] impliedly consents to subject himself to [that State's] jurisdiction," so too the corporation cannot be hauled into a State's court merely due to the ownership of its stock by an in-State shareholder. *Id.*

A corporation would have to direct its business activities purposefully into a State in order to subject itself to personal jurisdiction, including tax jurisdiction, in that State. *Burger King*, 471 U.S. at 472-473. There is a substantial risk that a decision allowing tax to be imposed on a nonresident trustee based solely on the in-state presence of a contingent trust beneficiary would be read as greatly expanding the power of states to tax nonresident corporations based solely on such corporations' relationships with various in-state entities, including but not limited to shareholders and other parties-in-interest.[12]

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[12] "There is considerable debate and uncertainty over whether, and the extent to which, federal constitutional restraints limit the States' power to impose income taxes on nonresident corporations with no or limited physical presence in the State, a point I simply note without pursuing the issue." Hellerstein, *Jurisdiction to Tax Income and Consumption in the New Economy: International, National, and Subnational Perspectives*, 38 Ga. L. Rev. 1, 47 fn. 149 (2003) (internal citation omitted). The College is concerned that a decision in favor of Petitioner could be used as a wedge by States to expand taxing power under the Due Process Clause based on resident shareholders' ownership of interests in non-resident, non-present corporations or similar entities.

III. THE TRUSTEE IN *HANSON* HAD FAR MORE CONTACTS WITH FLORIDA THAN THE KAESTNER TRUSTEE HAD WITH NORTH CAROLINA, YET FLORIDA LACKED PERSONAL JURISDICTION OVER THE TRUSTEE.

A. The Settlor-Beneficiary's Retention of Control Over Certain Aspects of the Trust's Operation Was Insufficient for Exercise of Personal Jurisdiction Over the Trustee in *Hanson*, Because the Trustee Did Not Purposely Avail Himself of Florida.

Enlarging State taxing jurisdiction over non-resident trustees based solely on presence of an in-state beneficiary would call into question the continued validity of *Hanson*, a case which the Court has repeatedly relied on in analyzing "minimum contacts" personal jurisdiction over non-residents.[13] The contacts between the non-resident trustee and the settlor-beneficiary in *Hanson* were far more extensive than those in the present case, but the Court determined those contacts to be insufficient under the Due Process Clause to exert Florida's State power over the nonresident trustee.

As this Court's jurisdiction-to-tax case law grows from the same roots that form the *in personam* and *in rem* jurisdictional framework described in *Hanson*, it would be unwise to create a variant jurisdictional test allowing North Carolina to exercise tax jurisdiction

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[13] See, e.g., *Walden v. Fiore*, 571 U.S. 277 (2014); *J. McIntyre Machinery, Ltd. v. Nicastro*, 564 U.S. 873 (2011); *Kulko v. Superior Court of Calif. In and For City and County of San Francisco*, 436 U.S. 84 (1978); *Shaffer v. Heitner*, 433 U.S. 186 (1977).

over a nonresident trustee. A close reading of *Hanson* illuminates the dangers to this Court's jurisprudence inherent in the relief sought by Petitioner. "The unilateral activity of those who claim some relationship with a nonresident defendant cannot satisfy the requirement of contact with the forum State . . . [I]t is essential in each case that there be some act by which the defendant purposefully avails itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws." *Hanson* at 253.

The trust at issue in *Hanson* was created in 1935 by settlor Donner, then a domiciliary of Pennsylvania, by execution of a trust instrument in Delaware naming Wilmington Trust Co. of Delaware the trustee. After funding the trust with securities, the settlor moved to Florida in 1944 and remained there until her death in 1952. The trust reserved to the settlor all income from the trust corpus for her life, with the remainder to be paid to the settlor's selected trusts or persons based on her inter vivos or testamentary instrument. *Id.* at 238.

The trust instrument reserved to the settlor the authority to change the trustee and to amend, alter, or revoke the trust at any time. *Id.* at 238. However, Wilmington Trust Co. remained the trustee throughout the duration of the trust and at the point of the settlor's death. Thus, during the period of the settlor's life in Florida, the Delaware-based trustee maintained a relationship with the settlor in Florida, including making distributions to the settlor of the trust's income during her life.

This Court analyzed whether the Florida court had jurisdiction over the trust assets *in rem* and over the nonresident trustee *in personam*. It easily dispensed with whether a court may enter an *in rem* judgment

dealing with property outside the forum State. "Since a State is forbidden to enter a judgment attempting to bind a person over whom it has no jurisdiction, it has even less right to enter a judgment purporting to extinguish the interest of such a person in property over which the court has no jurisdiction. Therefore, so far as [the Florida judgment] purports to rest upon jurisdiction over the trust assets, [it] cannot be sustained." *Id.* at 250.

As to *in personam* jurisdiction, the Court recognized the evolution of its precedents from the "rigid rule" of *Pennoyer v. Neff*, 95 U.S. 714 (1878), to the "flexible standard" of *Int'l Shoe*. *Id.* at 251. Applying the flexible standard, the Court found that "the defendant trust company had no office in Florida, and transacts no business there. None of the trust assets has ever been held or administered in Florida, and the record discloses no solicitation of business in that State either in person or by mail." *Id.*

The acts of the settlor/beneficiary in executing the powers of appointment in Florida were insufficient to provide jurisdictional nexus to the nonresident trustees. "The unilateral activity of those who claim some relationship with a nonresident defendant cannot satisfy the requirement of contact with the forum State." *Id.* at 253.

Of primary importance to the present case, appellant's argument that the domicile of "the settlor and most of the appointees and beneficiaries" in Florida gave the court personal jurisdiction over the nonresident trustees was deemed a "nonsequitur" because personal jurisdiction "is resolved in this case by considering the acts of the trustee" which were "insufficient to sustain the jurisdiction." *Id.* at 254. The Court reaffirmed that the restrictions of the Due Process

Clause "are more than a guarantee of immunity from inconvenient or distant litigation. They are a consequence of territorial limitations on the power of the respective States." *Id.* at 251. The trustee had no office in Florida and transacted no business there. None of the trust assets were held or administered in Florida, and there was no record of solicitation into Florida in person or by mail. No act was done or transaction consummated in the State giving rise to the underlying action. *Id.* The actions of the beneficiaries were of no consequence to the Court's analysis of jurisdiction over the trustee.

B. Ms. Kaestner's Contingent Interest Was Far More Limited Than That of the Settlor-Beneficiary in *Hanson* Due to the Legal Authority Granted to the Trustee and that She Was Only One of Several Potential Recipients of Distributions from the Trust.

"The person, property, or transaction" sought to be taxed by North Carolina is the income of the Kaestner Trust, not the income of the beneficiary. Therefore, the appropriate test is whether there is some "definite link, some minimum connection" between the Trust's income and the State of North Carolina, as a result of efforts by the trustee to "purposefully avail" the Trust of the protections of North Carolina. The presence in North Carolina of a contingent beneficiary of this nongrantor Trust cannot be a purposeful act of the trustee, since the trustee has no ability to control the acts of the beneficiary and does not select the beneficiary. Furthermore, neither the trustee nor the assets of the Trust have received any the benefits or protections of North Carolina.

There is only one trust instrument that controls the relationship between the trustee and the beneficiaries in this case: the Joseph Lee Rice, III Family 1992 Trust (referred to as the "Family Trust"). JA at 40 ¶ 9, 44-75. While Ms. Kaestner's portion of the Family Trust was divided into a "separate share trust" and named the "Kimberly Rice Kaestner 1992 Family Trust" (referred to by the parties as the "Kaestner Trust" or the "Trust"), it is administered under the terms of the Family Trust. Upon creation of the Family Trust and appointment of the trustee, the trustee took full title to the corpus of the trust.[14]

An examination of the material terms of the Family Trust shows that Ms. Kaestner was only one of several potential beneficiaries of the Trust. The trustee maintained legal power in his absolute discretion to control the Trust assets, to determine who received Trust distributions, and decide when those distributions would be made. While Ms. Kaestner and her children were primary beneficiaries,[15] the Third Article of the Trust established Joseph Lee Rice's spouse, his sister, and his sister's descendants all as contingent beneficiaries in the event the Trust assets were not fully distributed to the primary beneficiaries. JA at 52.

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[14] "When a settlor transfers property to another as trustee or declares a trust of that property, unless the transferor manifests a different intention, the trustee takes the settlor's full title or interest in that property." RESTATEMENT (THIRD) OF TRUSTS, § 2 (2003).

[15] While a "primary" beneficiary under the terms of the Trust instrument, Ms. Kaestner and her children were contingent beneficiaries of the Trust during the tax years at issue because they had no vested right to the current distribution of income from the Trust.

During all four tax years at issue, 2005-2008, the Trustee had "absolute discretion"[16] to make distributions of net income as he "may from time to time deem advisable." Trust Agmt. §1.2(a), JA at 47. He similarly had "absolute discretion" to make distributions of principal "as [he] . . . may from time to time determine." *Id.* at §1.2(b).

> If income of a trust is required to be distributed periodically, as annually, but distribution of the corpus is deferred, the gift of the income is one of a present interest . . . . A fortiori, if income is to be accumulated and paid over with the corpus at a later time, the entire gift is of a future interest, although upon specified contingency some portion or all of the fund may be paid over earlier. The contingency may be the exercise of the trustee's discretion, either absolute or contingent.

Fondren v. Comm'r of Internal Revenue, 324 U.S. 18 (1945).

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[16] A trustee with "absolute discretion" over whether to pay trust monies to a beneficiary cannot be required to pay over sums from the trust to creditors of the beneficiary. "No case is cited or known to the court which goes so far as to hold that an absolute discretion in trustees – a discretion which, by the express language of the will, they are under no obligation to exercise in favor of the bankrupt [beneficiary] – confers such an interest on the [bankrupt beneficiary] as can be successfully asserted in any court by him or his assignee in bankruptcy." *Nichols v. Eaton*, 91 U.S. 716, 717 (1875) (holding that creditors in bankruptcy could not claim any right to trust assets after the beneficiary's rights to receive trust distributions terminated under the terms of the trust instrument upon the insolvency of the beneficiary and that post-termination distributions made under the absolute discretion of the trustee could not be controlled by the beneficiary's assignee).

The trustee had the sole discretion to pay any of the potential Family Trust beneficiaries without making payments to any other beneficiary, and the trustee could exercise his discretion without regard to the assets already owned by any beneficiary. Trust Agmt. §1.4, JA at 50. The trustee further had the power to terminate the Trust at his discretion and to pay out the assets of the terminated Trust "in such amounts and proportions as the Trustee in the Trustee's absolute discretion may deem advisable." JA at 51-52. The gifts made by the settlor of the Trust to Ms. Kaestner and each of the other beneficiaries of the Trust was thus a future interest, not a present interest, which reinforces that there was no "present right of enjoyment" by Ms. Kaestner or the other beneficiaries. *See Fondren*, 324 U.S. at 502.

"[I]n addition to . . . those conferred by law," the trustee was invested with a broad range of powers and authority to manage the Trust assets, consisting of eighteen separate subsections within the Trust Agreement. Trust Agmt. § 5.2(a)-(r), JA at 55-60. Among the powers granted to the trustee was the power to "pay or contest any and all taxes assessed against any trust created hereunder" and to "do all such acts, take all such proceedings and exercise all such rights and privileges, although not herein specifically mentioned, with respect to any such property, as if the absolute owner thereof . . ." *Id.* at 5.2(q)-(r).

The Trust Agreement was made irrevocable and unamendable by the settlor, who declared that "[s]ubject to the Trustee's power to change the situs of the trust property of any trust hereunder, this Agreement and each trust hereunder shall be governed . . . according to the laws of the State of New York." JA at 69.

While the Trust Agreement contemplated that Ms. Kaestner and her children would be the recipients of distributions of the Trust's income and principal, nothing in the Trust instrument mandates such an outcome during the tax years at issue. The possibility that the income of the Trust might in the future be distributed to the beneficiary (such as Ms. Kaestner) does not create a current connection between the Trust's income and the State in which the beneficiary resides. If any distributions were made to Ms. Kaestner or her children while they were residents of North Carolina, the distributions of current year net income of the Trust would be subject to North Carolina income tax.

To the extent North Carolina imposes a throwback rule, prior year's trust income might also be taxable.[17] In an irrevocable nongrantor discretionary trust such as the one established by Ms. Kaestner's father, the trustee may make no distributions to a beneficiary for a span of many years, in the absolute discretion of the trustee. So long as the trustee's decisions are within the Trust's instructions and not an abuse of discretion, a primary beneficiary might never receive any distribution from the Trust, which instead may pass to other contingent beneficiaries.[18]

Contrast Ms. Kaestner's contingent expectancy interest as a beneficiary with that of the settlor-beneficiary in *Hanson*, who created her trust, funded

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[17] For a discussion of throwback rules, see footnote 25, *infra*, and the references cited therein.

[18] "Where discretion is conferred upon the trustee with respect to the exercise of a power, its exercise is not subject to control by the court except to prevent an abuse by the trustee of his discretion'" *Conkright v. Frommert*, 559 U.S. 506, 521–22 (2010) (quoting RESTATEMENT (SECOND) OF TRUSTS § 187 (1957)).

her trust corpus, reserved to herself the trust's income for life, and controlled the decisions of the trustee by means of the trust advisor and the ability to terminate the trust. Ms. Kaestner's contingent expectancy interest was minimal in comparison to that of Ms. Donner, further demonstrating the thinness of the jurisdictional reed upon which Petitioner's position is based. North Carolina should not receive taxes on income generated outside the State by a trustee residing outside the State using assets sitused outside the State solely because a potential future recipient of trust distributions happened to reside in the State during the tax years at issue.

The rationale for a State's right to tax income of its residents was explained by this Court in 1932: it is "founded upon the protection afforded to the recipient of the income by the state, in his person, on his right to receive the income, and in his enjoyment of it when received." *Lawrence v. State Tax Comm'n.*, 286 U.S. 276, 281 (1932).[19] Note that this description focuses on *receipt* of income, *right* to receive income, and the presumption that receipt of income allows *enjoyment* of that income. During the tax years at issue, none of these elements exists with respect to Ms. Kaestner: she did not receive any income generated by the assets in the trust, did not have any right to receive that income, and never enjoyed the benefit of the income. The underlying rationale of residence-based taxation

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[19] Taxation based on source of income, rather than residence of the income's recipient, is more circumscribed. The power derives from the protection that states provide to "persons, property, and business transactions within their borders." *Shaffer v. Carter*, 252 U.S. 37, 57 (1920). Since the income at issue was not derived from assets within North Carolina's borders, North Carolina cannot assert source-based taxation.

is not met under these facts, making it inequitable to impose the State's residence-based tax authority over income of the trust to which the resident beneficiary had no receipt, right, or enjoyment.

C. The Due Process Limits On The Extra-territorial Exercise of State Power Recognized In *Hanson* Counsel Against Extension Of North Carolina's Taxing Jurisdiction In This Case.

Petitioner attempts to distinguish *Hanson* by confining its jurisdictional analysis to adjudicative jurisdiction only. Pet. Br. at fn. 9. However, the jurisdictional reach of a State to impose a tax should be concomitant with the State's power to adjudicate disputes, since State taxing power must ultimately be exercised through adjudicative procedures in the taxing State.[20]

The North Carolina trust income tax is computed using the federal taxable income reported for the trust.[21] North Carolina law mandates that the trustee of the trust must file a trust income return and must pay the resulting tax computed. N.C. Gen. Stat. 105-160.2

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[20] It is doubtful that North Carolina's taxing power could be adjudicated in any forum other than North Carolina's state courts or this Court. *See, e.g., Fair Assessment in Real Estate Ass'n, Inc. v. McNary*, 454 U.S. 100 (1981); Tax Injunction Act, 28 U.S.C. § 1341 (1948); *Franchise Tax Bd. of Cal. v. Hyatt*, No. 17-1299 (U.S., filed March 12, 2018) (case submitted January 9, 2019 – decision pending).

[21] Line 1 on North Carolina's trust income tax form D-407 requires entry of "the federal taxable income from [IRS] Form 1041." N.C. Dept. of Rev. Form D407-A (Instructions for Form D-407).

and 105-160.5 (2017). The beneficiary plays no role in the filing of the return or the payment of the tax.

Taxation of a trust must be exercised against the trustee, as the trustee is the only person with the legal power to handle the trust assets and thereby pay the tax sums demanded by the State. Ms. Kaestner would have had no ability to pay the sum and no access to the information necessary to prepare the return.

Had the trustee not filed the return at all, or had the trustee filed the return but not paid the tax owed, any action taken by the North Carolina Department of Revenue to impose a liability upon the trust for unpaid income tax, or to collect upon such liability, would have required service upon the nonresident trustee and personal jurisdiction of the North Carolina courts over the trustee.[22] The same Due Process limitations which prevented Florida's chancery court in *Hanson* from exercising personal jurisdiction over a nonresident trustee – who had far more contacts with the Florida domiciled settlor-beneficiary of the trust than the contacts shown in the present case – prevent exercise of personal jurisdiction by North Carolina's courts to adjudicate any liability of the nonresident trustee for tax sums allegedly owed.

Adjudicative jurisdiction should not be separated from prescriptive or tax jurisdiction. Adopting Petitioner's argument would lead to a twisted branch of the Due Process Clause jurisprudence in which a State has power to tax a nonresident trustee solely based on the contacts imputed to him due to a resident

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[22] *See, e.g.*, N.C. Gen. Stat. § 105-243 (2017), authorizing the North Carolina Attorney General, upon request of the Secretary of Revenue, to commence an action in court to recover tax alleged to be due from a taxpayer.

contingent beneficiary, yet the same State would lack the power to bring the nonresident trustee before its courts to adjudicate and enter a binding judgment enforceable against that trustee regarding the tax liability of the trust.[23] *Quill* wisely relied on adjudicative jurisdiction case law (*Int'l Shoe*; *Burger King*; and *Shaffer*) in analyzing tax jurisdiction, since the power to tax should work hand-in-glove with the power of the courts to enforce the tax. If a State court cannot obtain personal jurisdiction over the "person, property, or transaction" to be taxed, the tax cannot be reduced to a judgment and enforced due to the absence of a necessary party. Thus, the power of the department of revenue to levy the tax should not exceed the authority of the State courts to enforce such tax where the person, property, or transaction sought to be taxed lacks the minimum contacts necessary for enforcement of the State tax law.

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[23] "Although it is conceivable that a natural or juridical person could be considered a resident for substantive jurisdiction-to-tax purposes but not for personal jurisdiction purposes or vice versa, the possibility seems sufficiently remote as to require no further discussion." Hellerstein, *Jurisdiction to Tax Income and Consumption in the New Economy: International, National, and Subnational Perspectives*, 38 Ga. L. Rev. 1, 9 fn. 23 (2003).

IV. CONNECTICUT'S TAX POLICY CHOICE DOES NOT EXPAND NORTH CAROLINA'S TAXING POWER BEYOND THE BOUNDARIES OF THE DUE PROCESS CLAUSE.

Petitioner argues strenuously that the result reached in the court below is unfair because of the possibility that a trust might avoid State income taxation depending on the State in which its trustee resides. Petitioner's discussion fails to acknowledge that every State maintains the power, consistent with the Due Process Clause, to tax the income of a trust within its taxing jurisdiction.

The Kaestner Trust could have been subject to income tax in the State of Connecticut but for the policy decision of that State to draft its trust income tax law to tax only "resident trusts" and to define a "resident trust" to mean a trust with a Connecticut settlor. Conn. Gen. Stat. § 12-701(a)(4)(C)-(D) (2013). Had Connecticut defined a resident trust to be one in which the trustee is a resident of the State, similar to at least fourteen other states,[24] the income of the Kaestner Trust would have been taxable there.

States retain expansive powers to impose taxes upon persons and property within their jurisdictional boundaries. In addition to their power to impose taxes on income generated by their residents and income generated by assets located in their borders, states may impose property taxes upon tangible and intangible property coming within their jurisdictional scope, including such assets held in trusts. States may

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[24] Arizona, Colorado, Hawaii, Indiana, Iowa, Kansas, Kentucky, Mississippi, Montana, New Mexico, New Jersey, Oregon, South Carolina, and Utah are states that tax trust income based on the presence of an in-state trustee or trust administration.

impose wealth taxes – measured by unrealized capital gains – if they are concerned that capital may be converted to income after the resident elects to move to an income-tax free jurisdiction. They may implement throwback tax provisions to capture accumulated prior years' income once a distribution is made to a trust beneficiary.[25]

Petitioner's hypothetical situation in which a trust beneficiary changes his or her permanent domicile to Florida prior to receiving a large distribution from a trust, and thereby is not taxed on the income resulting from that distribution, is not a "tax shelter." The policy choice by some states not to levy an individual income tax is part-and-parcel of our republican form of government in which each State is left to determine for itself the means and methods of taxation that best suit its needs. U.S. Const. art. IV, § 4, cl. 1.

Once a State makes its tax policy choices, a citizen may react accordingly, "arrang[ing] his affairs so that his taxes shall be as low as possible; he is not bound to choose that pattern which best pays the treasury. There is not even a patriotic duty to increase one's taxes. Over and over again the Courts have said that there is nothing sinister in so arranging affairs as to keep taxes as low as possible." *Gregory v. Helvering*, 69 F.2d 809, 810 (2d Cir. 1934), *aff'd*, 293 U.S. 465 (1935).

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[25] Pennsylvania, California, and New York have implemented throwback tax rules, which tax accumulated income received by a trust beneficiary in prior years, once the beneficiary receives a distribution that exceeds the distributable net income of the trust for the current year. *See* Amicus Brief for ACTEC at 15-19, describing the "throwback" tax regime.

The decision of a State such as Florida not to tax individual income, thereby creating an incentive for individuals receiving income to become domiciliaries of Florida, does not expand the jurisdictional reach of income-taxing states on the grounds that income might "escape taxation." There is no universal requirement that all income must be taxed by at least one State or that all capital must be taxed.[26] If taxpayers arrange their financial affairs in compliance with the tax policies each State adopts, and properly comply with those State tax systems, the fiscal impact on taxing authorities cannot be deemed unfair.[27]

As one example, a North Carolina resident may own stock of a corporation that increases in value. If the North Carolina resident lawfully changes his domicile to Florida before selling the stock, thereby avoiding North Carolina income tax on the now-realized capital gain in the stock value, the liberty of the taxpayer to arrange his affairs to avoid imposition of that tax is

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[26] Taxes might not be imposed upon a particular person, property, or transaction either because (1) a legislature has imposed a tax but then carved out an express exemption or exclusion prohibiting the tax from being applied to a particular situation, or (2) the State has chosen not to adopt a particular type or structure of tax. It is misleading and erroneous to label such non-tax situations as "tax avoidance" or "tax shelters" when they arise from the choices made by individual State legislatures.

[27] What would be unfair, and likely an irresolvable problem, is determining what percentage of a trust's income the State of a potential beneficiary may tax. If there is a class of potential beneficiaries, any of whom might ultimately receive a presently-undetermined future distribution of trust income, and those beneficiaries are present in multiple States, it would be essentially impossible – or wholly arbitrary – to fashion a workable apportionment methodology splitting the trust's income among the class of contingent beneficiaries spread across multiple States.

perfectly lawful. *See, e.g., Fowler v. N. C. Dept. of Revenue*, 775 S.E.2d 350 (N.C. App. 2015).

States desiring to avoid this situation can impose an annual property tax on intangibles[28] or a wealth tax measured by unrealized capital gain. What the State cannot do is reach undistributed income in the legal possession of a nonresident trustee having no contacts with the forum State based solely on one potential future beneficiary's presence in the forum State.

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[28] As least as far back as 1937, North Carolina's property tax law (known as the North Carolina Machinery Act) included annual *ad valorem* taxation of intangibles, including stocks and bonds. 1937 N.C. Sess. Laws, ch. 127, Article VIII, Schedule 8, § 700 (levying the tax); 1939 N.C. Sess. Law ch. 310, § 2(10) (defining "intangible property" to include "patents, copyrights, secret processes and formulae, good will, trademarks, trade brands, franchises, stocks, bonds, cash, bank deposits, notes, evidences of debt, bills and accounts receivable, and other like property.") This Court held in *Fulton Corp. v. Faulkner*, 516 U.S. 325, (1995) that North Carolina's intangibles tax on stock levied on a fraction of the value of corporate stock owned by State residents inversely proportional to the corporation's exposure to North Carolina income tax was discriminatory against interstate commerce in violation of the dormant Commerce Clause. The following year, the North Carolina legislature chose to exempt most forms of intangible personal property from ad valorem taxation. 1997 N. C. Sess. Laws ch. 23, § 1 (codified at N.C. Gen. Stat. § 105-275(31) (2017)).

CONCLUSION

For the foregoing reasons, the College respectfully submits that the decision of the Supreme Court of North Carolina should be affirmed.

Respectfully submitted,

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